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Criticisms and suggestions on the cross-conditionality of the IMF and the World Bank

Patricio Meller

In order to make the problem of external debt compatible with that of the economic growth of Latin American countries, the adoption of a "growth-oriented adjustment" strategy has been suggested. Since both the International Monetary Fund and the World Bank are called upon to play an important role in this strategy, there is a need to review and co-ordinate the conditionalities imposed by both institutions. This need is related to the fact that the current deficits in the balance of payments of the Latin American countries are structural, and therefore must be dealt with in the long term; on the other hand, it has been proven repeatedly that short-term macroeconomic adjustment affects the pattern of long-term growth.

Given this interaction, it becomes necessary to co-ordinate the economic programmes sponsored by the Fund and the Bank. Moreover, in practice, the Bank adjustment programmes have generally been applied in a context in which a Fund programme is already in operation. Hence it is difficult to isolate the effects of each institution's programme. The need for uniformity and consistency within and between them lead to the subject of cross-conditionality.

It would seem appropriate for Latin American economists to formulate their suggestions and proposals *a priori*, rather than expressing their criticisms *a posteriori*, concerning the nature and components of the type of cross-conditionality that may soon be put into effect, which will probably have more serious effects than did the one imposed by the IMF in recent years.

This article makes a contribution to the criticism of this cross-conditionality and to the formulation of some alternative proposals.

*Researcher for the Economic Research Corporation for Latin America (CIEPLAN).

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At Bretton Woods (1944) it was stipulated that the key concern of the International Monetary Fund (IMF) would be the short-term adjustment problem faced by a country experiencing an external imbalance; on the other hand, the World Bank would be oriented toward long-term goals, such as promoting economic growth and development. This differentiation of roles has caused a crisis in the 1980s. There is a consensus that the deficits in the balance of payments of Latin American countries (and of developing countries in general) are structural and therefore must be dealt with on the long term. It has been proven, however, that short-term macroeconomic adjustment affects the future pattern of growth. In other words, economic conditions have an impact on what happens in the long run; likewise, in order to solve problems related to these conditions, a broader time perspective is needed. In view of the interaction between the short term and the long term, there must be some degree of co-ordination among the economic programmes proposed by the IMF and the World Bank. In practice, World Bank adjustment programmes generally have been applied in a context where an IMF programme is already in operation. Consequently, it is difficult to isolate the effects of each institution's programme. The need for uniformity and consistency within each and between the two leads to the subject of *cross-conditionality*.

Latin American economists have repeatedly asserted their criticisms of, and disagreements with IMF conditionality.[1] However, it is probable that the adoption of a "growth-oriented adjustment" strategy will confront Latin American countries in the near future with a cross-conditionality imposed by the Fund and the Bank. It would seem wise, then, for the economists of the region to formulate their suggestions and proposals *a priori*, rather than expressing their criticisms *a posteriori*, regarding the nature and components of this cross-conditionality, whose elements certainly require an analysis of the above-mentioned strategy.

[1]Bibliographical references on this subject: Bacha (1983), Buira (1983), Ground (1984), Killick (1984), David (1985). For a more recent review, see SELA (1986), Marshall (1987), Meller (1988), Pastor (1987).

The purpose of this work is to examine the problems involved in these topics. In the first section, the new role of the IMF and the World Bank in the external debt problem of Latin America will be discussed. The second section will deal with the various elements linked to the strategy of "growth-oriented adjustment" and the (possible) cross-conditionality to which it would be subject. The third section explores some proposals for modifying the conditionalities of these institutions, taking into consideration recent concerns in the region.

I

The Latin American foreign debt and the new roles of the fund and the Bank

1. *The new role of the International Monetary Fund*

In response to the virtual collapse of the international financial system in 1982 owing to the problem of the Latin American foreign debt, the International Monetary Fund (IMF) has performed an important role of intermediary between debtor nations and creditor banks. The Fund organized and co-ordinated complex packages of financial resources from very diverse sources, which helped to confront the insufficiencies of external liquidity of many countries of the region in 1982-1985. In that period the IMF also significantly increased the volume of loans committed from its own resources.

In assuming this role of intermediary, the IMF has imposed conditions on both debtors and creditors. Debtors have had to adopt adjustment programmes that include the *total* payment of debt servicing. Similarly, creditor banks have had to supply, "not very voluntarily", additional loans in order to bolster the packages put together by the Fund, in which its contributions were merely one of the components.

It should be remembered that the basic function assigned originally to the IMF consists of providing loans to countries that are experiencing external payments difficulties related to current economic conditions; i.e., the Fund's role is fundamentally short term and centred on the deficit in balance-of-payments *flows*. As Bacha notes (1985), when the IMF assumed the role of intermediary in the Latin American debt problem, it was showing a specific concern for a long-term *stock* problem. Underlying this proposal is the basic idea that the Latin American foreign debt and its prompt servicing is *not* due to a temporary lack of liquidity, but to a *critical* problem of stock imbalance.

Nevertheless, this new role of intermediary presents the IMF with new difficulties (Bacha, 1986). Consider the case of a debtor country that cannot comply with the economic adjustment programme. If the IMF decides to suspend the programme, this will cause an economic crisis in the debtor country, which, without the Fund's seal of approval, will be unable to obtain external resources. In other words, the signing of an economic programme with the IMF provides indispensable external credibility to the country's economic programme.[2] The suspension of the programme inevitably raises questions about how the Fund could have proposed a non-viable economic programme, questions which cannot help but discredit the Fund itself. On the other hand, if the IMF maintains the flow of loans, despite the failure to meet the goals, it is also risking a loss of external credibility as an international supervisory agency.

2. *The problem of asymmetry*

There is an asymmetrical situation with regard to the problem of external imbalance, depending on whether the country is industrialized or less developed (LDC). The IMF has been unable to

[2]In some cases the signing of an economic programme with the IMF also provides a certain domestic credibility. In others, it may become a triggering factor in domestic instability.

convince the industrialized countries to apply a consistent, uniform economic programme that promotes international financial stability and world growth.

Moreover, although the external imbalance and the fiscal deficit of the United States economy have been at the core of the world economy's unsatisfactory functioning in recent years, the IMF can do nothing to surmount them. How would the United States government and people react if the Fund suggested that they reduce the size of their fiscal deficit from 4% to 2% (of the GDP) within one year? A quantitatively similar and sometimes even greater demand is stipulated in most of the standby arrangements signed by Latin American countries with the IMF.

The maintenance of a stable world economic and financial system today depends essentially on the policies applied by the industrialized nations. Sometimes, not only is there an asymmetry in the conditionality —the latter applying only to LDCs— but as a result the IMF cannot even fulfil its main function. It has become a mere spectator and commentator with regard to world economic trends, unable to influence or alter their course (Miller, 1986). Given this inability to convince the industrialized nations to modify their policies, the IMF (and the World Bank) should at least be concerned with the probable effects on the functioning of the world economy and on the LDCs (Please, 1987).

Indeed, if the industrialized nations apply policies that adversely affect the world economy, the LDCs are going to suffer the consequences;[3] hence they had best be warned, so that they can use the appropriate tools to try to neutralize the impact. They must be aware, then, that however restrictive the conditionality imposed on the LDCs either to eliminate the external imbalances or to ensure continued flows of debt servicing, it would not lead to an orderly growth of the world economy, which primarily depends on the policies of the industrialized nations.[4]

[3]The impact of the hike in the real international interest rate in the 1980s has been quantitatively around 50% of the total amount of interest paid by Latin America during the 1982-1986 period; see Meller (1988).

[4]The LDC economies are a mere appendix to the industrialized economies. In the LDC economies what happens in the industrialized economies is expanded cyclically.

This international asymmetry entails another basic problem. The fact that there are countries with a trade deficit necessarily implies that others are accumulating a surplus. Then why, in view of the existing imbalance, should only those with a deficit bear the brunt of adjustment? The obvious answer would be that only the countries with a trade deficit face problems of financial liquidity; and this is what leads Latin American governments to turn to the IMF. However, this need not be so. Already in the 1940s, when the creation of the IMF and the World Bank was being discussed, Keynes advocated symmetry in the distribution of the costs of adjustment.

The countries with trade surpluses have to permit access to the exports of deficit countries, so that they are able to generate the foreign exchange necessary for financing the deficit. This is exactly what the United States has recommended recently to Japan. In order to alleviate the burden of adjustment linked to the United States external imbalance, Japan has declared that it is willing to increase its imports from the United States and "voluntarily" reduce its exports to that market.

In sum, the Fund is facing a number of dilemmas in fulfilling its function of supervising the orderly, stable growth of the world economy. How can the IMF influence the economic policies of the industrialized nations? How can it have an influence on countries that do not need loans from it? How can it suggest changes in the policies of countries with a trade surplus? (Kenen, 1987). The overall problem seems to be associated with the concession of the appropriate mechanisms so that the IMF can have a *symmetrical* influence on the industrialized nations and on the less developed countries, or on the surplus and deficit countries, so as to promote a more equitable distribution of the costs of adjustment where external imbalances exist. For example, the IMF could rely upon various mechanisms to induce trade surplus countries to facilitate access to the exports of deficit countries.

3. *The new role of the World Bank*

In the 1970s, the global perception of the World Bank (Annis, 1986; Feinberg and others, 1986) was that in the LDCs the benefits of greater

growth did not reach the poor, thus invalidating the "trickle-down" theory. The growth-oriented redistribution approach, which suggested that in the LDCs it is possible to achieve redistribution without sacrificing growth, was then tried. The alleviation and/or elimination of poverty became the conceptual focus of the Bank, and actually became a moral goal. This new approach took the form of credits for investment projects that directly benefited specific poor groups.

In the 1980s a change in the focal point of the Bank's efforts has taken place. A negative view of LDC institutionality and economic policies has arisen. It is said that *poor and unsound policies and weak and corrupted institutions* prevail in them. Since the level of investment depends, among other factors, on the global economic context, the conclusion is drawn that in many countries the prevailing policies and institutions introduce an enormous mass of distortions. Consequently, it is very difficult for the World Bank to find viable investment projects to which it can grant financing. Within this framework, the institution has created new lines of credit aimed at supporting countries that must undertake structural adjustments in order to resolve external imbalances rather than financing specific projects.[5] The content of such programmes is the basis of the Bank's new conditionality. Its purpose is to boost the general efficiency of the economy by establishing suitable incentives, a goal which assumes changes in trade and price policies, the size and structure of the State and the role that the government plays in the economy.

The Bank's current view is that the most common distortions in the LDCs (Michalopoulos, 1987) are price controls, very differentiated incentives among tradeable goods, a subsidized interest rate, credit control and obstacles to the mobility of the labour factor and to the adjustment of real wages. Improved efficiency in the allocation of resources and in productivity can be attained through the removal of price controls, the liberalization of the external sector and the lifting of prevailing regulations in factor markets. The latter policy, in the case of the capital market, improves the allocation of credit and therefore of investment, while the deregulation of the job market results in a more efficient allocation of labour.

On the other hand, given the serious external imbalance, it is important for the LDCs to increase their production of tradeable goods. According to the World Bank, this requires a stable macroeconomic context, which provides an appropriate exchange rate and a structure of incentives that is neutral with respect to production for the domestic or external market. This neutrality demands, in turn, a complete rationalization and liberalization of foreign trade, which suggests the elimination of quantitative restrictions and non-tariff barriers on imports, together with tariff reductions, the establishment of equal (and low) tariffs and the lowering, and abolition if possible of export taxes. It is not advisable to apply sequentially the liberalization of imports after exports have been expanded and the country has acquired enough international reserves; it is preferable to do all this simultaneously. In addition, it is recommended that incentives be increased in order to attract foreign investment, avoiding discriminatory treatment between national and foreign enterprises. Finally, a complete re-evaluation of the government's role as owner or operator of public enterprises is suggested, with various alternatives for denationalizing and privatizing being presented (Michalopoulos, 1987; various World Bank internal reports).

These economic reforms would thus be far-reaching. It should be noted that IMF conditionality —although it may be strict, inappropriate and imperfect— interferes or intervenes considerably less in internal affairs than any such as the above which might be imposed by the Bank. The conditionality of the Fund, oriented as it is toward reducing external and domestic imbalances, uses a conceptual framework based on budget restrictions. On the other hand, that of the World Bank, based on the liberalization of markets and the external sector, deregulation and privatization, requires a conceptual framework of dynamic growth strategies in an imperfect world of "second best". There is no firm and consistent theoretical (or empirical) basis for such an exercise (Helleiner, 1986; Sachs, 1986).

[5] In 1980 only four of the credit operations of the World Bank were oriented toward sectoral or structural adjustment, for a total amount of US$370 million. In 1987, there were 31 operations of this type, and their total amount came to cover US$4.1 billion.

Other doubts about this possible conditionality (Annis, 1986; Feinberg and others, 1986) put stress on how biased the Bank's view of the LDCs is. The Bank shows a marked hostility toward government intervention and public enterprises, since they are indiscriminately considered to be obstacles to growth. Government interventions in the growth of the economy are always "bad" and introduce distortions; it is therefore necessary to reduce its degree of involvement. Public enterprises are inefficient by definition; that is why privatization *per se* leads to an increase in efficiency and prosperity. Public bureaucrats are always viewed as inept and corrupt, and private businessmen as efficient and honest.

The existing evidence in Latin America in these matters suggests that reality is not so black and white, but a great deal more complex. Likewise, structural adjustment lending (SAL) programmes are quite ambitious and include a package of economic reforms that implies a clear interference in the development strategy, the management of economic policies and the evolution of distribution and redistribution patterns. In most Latin American countries this interference is considered to be simply intolerable.

In short, it would be better for the World Bank to resume the approach that it advocated in the 1970s —which gave priority to alleviating and eliminating poverty—, while avoiding making the same mistakes. It is true that the LDCs have to undertake structural reforms, but there is much uncertainty about the most appropriate sequence and rate of application. On the other hand, each case is different and depends on the initial conditions and on political feasibility. Thus, it is vital that the decisions remain in the hands of the governments.

As for the debt problem, until 1984 the Bank maintained a passive attitude, which to a certain extent responded to the prevailing view in the industrialized nations that the lack of liquidity was only temporary. Given the persistence of the problem and the paucity of external credit alternatives, the LDCs increased their demand for the credit resources that were idle and stagnating in the Bank. Since 1985, the Bank has adopted a more active attitude, upon perceiving that the debt problem has an adverse effect on LDC growth, which in turn leads primarily to difficulties in finding viable investment projects.

The Baker initiative or plan consolidates this more active role. On the one hand, the IMF suffered a major institutional deterioration during the costly adjustment process of 1982-1985, and a different international institution was then needed to replace it; on the other hand, there was an important change of emphasis in the perception of the debt problem, when concern began to be expressed about the growth of debtor countries during the adjustment period.

The World Bank has performed a significant role for some Latin American debtor countries (Chile, Colombia, Mexico and Panama) as a catalyst or backer of new loans from international private banking; in other words, the fact that it provides loans or backing has facilitated the concession of commercial bank loans. In this sense, international private banking would like the Bank to go much further and expand its backing to either existing loans or any future flow. Obviously, the institution resists this type of pressure, and any bank which grants a loan for investment must therefore assume the risks involved in the operation (Feinberg and Bacha, 1987).

II

Growth-oriented adjustment

This strategy corresponds to an earlier regional proposal. In light of the experience of the many programmes signed by Latin American countries with the IMF, for some time there has been fairly widespread agreement that they reduce the external imbalance, but at a high domestic cost. Furthermore, they do not lead the economy down the road to stable, high and viable growth, since they do not produce the structural changes required.

Today, everyone speaks of "growth-oriented adjustment". However, there are serious disagreements over the package of economic policies required for implementing this strategy.

1. *Possible conflict between adjustment and growth*

A macroeconomic adjustment programme may require a significant decrease in the fiscal deficit and a decline in the rate of increase of domestic credit. The reduction of the fiscal deficit may imply, in turn, a hike in the taxes on all economic agents, including exporters, and a cutback in public spending, which would also affect public investment. On the other hand, a contraction in domestic credit erodes the financial resources available for sustaining investment. Consequently, the previous macroeconomic programme, geared toward inducing adjustment, would not be a positive stimulus for growth; i.e., there would be some degree of *trade-off* between adjustment and growth.

However, it is possible to argue that macroeconomic adjustment is a prerequisite to a sustained, long-term growth. A stable macroeconomic environment, that is, one that is free of imbalances (domestic or external) and that has stable economic regulations, encourages and motivates the economic agents to adopt a long-term perspective.

2. *(Possible) cross-conditionality between the Fund and the World Bank*

There are two distinctive elements that provide the conceptual frame of reference used implicitly or explicitly in the elaboration of a possible cross-conditionality between the two institutions. They are the "multilateralist" view prevailing in the 1980s and the successful growth experience of Asian exporter countries.

The "multilateralist" view prevailing in the period prior to 1980 held that international economic *co-operation* could play an important role in promoting world prosperity and development. The prevailing view today in industrialized nations and international organizations is very different (Dadzie, 1987). According to this view, the economic difficulties experienced recently are the result of inappropriate domestic policies in the LDCs and in industrialized nations. The solution would then consist of applying the "appropriate and correct" (macroeconomic) policies, and introducing structural adjustments oriented toward increasing the flexibility of the economy in order to enable a more efficient allocation of resources. Each country has to "put its house in order" and adjust its economy in response to possible exogenous changes in external variables. From the standpoint of development, this serves to facilitate trade and financial flows; what is crucial is *not* the improvement of the international setting but the establishment, in each economy, of adequate incentives so that the private sector becomes the engine of growth. The interdependence of the world economy has become so complex that even a co-ordinated action by the governments of the industrialized nations cannot alter the sequence of events.

On the other hand, using the successful growth experience of Asian exporter countries as a reference, it is foreseeable that the new Fund-World Bank *cross-conditionality* will suggest to the LDCs that they adopt a development strategy based on export promotion ("outward development"). It should be noted that most Latin American economists, as well as ECLAC, agree with this. The key disagreement lies, however, in the package of economic policies needed to implement the strategy.

In short, the economic framework of *cross-conditionality* would be based on the following principles: application of "responsible, appropriate and correct" macroeconomic policies (such as monetary and fiscal policies); motivation and augmentation of savings and investment; boost in the production of tradeable goods and, in particular, export promotion, and establishment of a more appropriate structure of incentives in the local economy.

At this level of generalities, it is very difficult for any economist to disagree. Who could oppose responsible, appropriate, correct and adequate policies?[6] Then why have the LDC governments not decided to apply them? The commonplace answer is that the most appropriate, correct and

[6]Only an irresponsible, incorrect or inadequate economist could disagree.

responsible economic programme is not obvious in the economies of a "second best" world, with their imperfections, distortions and political and economic pressures, and in countries whose governments are dedicated to very disparate objectives (greater growth, lower inflation, less unemployment, more equitable distribution of income, alleviation of poverty and reduction of the external imbalance), among which there are trade-offs of unknown but severe proportions, especially in a dynamic context.

The growth-oriented adjustment strategy based on the promotion of exports, implicit or explicit in the (possible) *cross-conditionality* between the Fund and the World bank, would contain the following elements (Guitián, 1981 and 1987; Krueger, 1978; Balassa and others, 1986; Michalopoulos, 1987):

i) Liberalization of markets and the external sector. The central component of the latter is import liberalization.

ii) Granting of incentives to expand exports, such as devaluing local currency, maintaining a stable real exchange rate and cutting export taxes.

iii) Transformation of the private sector —national or foreign— into an engine of economic growth, which is often a euphemism for the privatization of public enterprises.

iv) Enforcement of stable, permanent economic regulations, hand-in-hand with less government intervention in the economy and, in connection with the previous point, a reduction in the size of the State in the economy.

3. *Review of the Asian experience*

It would seem that there are very different interpretations of the policies used in the successful Asian export experience.

Sachs (1987) has examined the series of policies applied by Japan in the period (1950-1973) in which the country reached one of the highest annual average rates of economic growth.

i) *Exchange rate policy.* The government held absolute control over foreign exchange, and exporters had to surrender all foreign exchange generated. Public bureaucrats allocated the foreign currency among the various sectors and enterprises, without subjecting them to specific norms. During the 1950-1964 period, official foreign currency was not granted for tourism.

ii) *Capital account.* The government was the only economic agent that could request external credit; foreign investment was subject to strong controls, and the entry of multinational corporations controlled mainly by foreigners was not permitted.

iii) *Interest rate.* The real interest rate was low and subject to a maximum ceiling; the granting of credit was discretionary.

iv) *Incentives for exporters.* Overseas sales were promoted, not through the import liberalization mechanism but through specific fiscal incentives (subsidies and tax exemptions), which were extended to exports with natural comparative advantages.

In short, according to the above-mentioned author, the Japanese export experience was based neither on free trade nor on a freely operating market mechanism, indeed it was not at all outside the sphere of government influence.

It should be noted that in several Latin American countries an economic programme apparently similar to that described was applied. Why, then, were the results not similar? Possible answers are: there is no single economic formula to achieve a given objective, in this case export promotion; or rather, the same formula, applied to different economies and under different world economic conditions, can produce different results. In our judgement, however, during the 1950-1970 period in most Latin American countries the incentives were biased against exports (permanently overvalued local currency, high import barriers, etc.), and there was even a certain pessimism about export potential.

As for the non-Japanese Asian strategy, which was also successful, Sachs points out that export promotion is the engine of economic growth, but that it is not equivalent to mere import liberalization. The latter is not a prerequisite to export promotion either. The same can be said of the "pure" role of the market and the State in the economy. In Korea, the authorities promote the formation of large commercial businesses that distribute export products; and although there is no equivalent to the Japanese MITI (famous for its guidelines for future export areas), the government puts pressure on the major export firms and interacts with them, playing an active and important role.

In sum, the package of economic policies produced by the successful Asian export promotion strategy is unlike that contemplated in the "liberalization and deregulation" associated with (possible) cross-conditionality.

4. *Some difficulties with a (possible) cross-conditionality*

The economic programme suggested by the proposed cross-conditionality between the IMF and the World Bank would supposedly result in growth-oriented adjustment, thereby enhancing the prosperity of the country that accepts it. This leads to a dual paradox (Streeten, 1987). On the one hand, if the economic programme associated with cross-conditionality benefits those that implement it, then why do governments not apply it *motu propio*? Why is it necessary to put pressure on them to do so through cross-conditionality? (Sachs, 1987). On the other hand, if that economic programme is really so good, why do the countries that decide to apply it not pay for the advice, receiving an "award" in exchange (access to credit)?

Streeten lists 10 reasons to explain this dual paradox. Their key elements are: i) the short-term costs involved in this strategy can be very high, and ii) there may be serious disagreements between international institutions and countries over the functioning of the economy and perceptions and expectations about future changes. Regardless of these explanations, the first part of the dual paradox deals with the central problem of the conditionality of multilateral institutions. There is something in its components that makes it unattractive to the countries in need of external financing. In fact, if there are credit alternatives other than those represented by multilateral institutions, they will be preferred, although their cost may be higher (as was evident at the end of the 1970s). This calls into question the role of multilateral institutions which may eventually become mere lenders of last resort. In that context, one of the conclusions of the case study by Killick (1984) is that the traditional IMF adjustment programmes have a greater probability of success when the local government really agrees to apply them. Summing up, it seems to be vital to increase the dialogue between the different parties, in other words, countries and multilateral institutions.

The possibility of cross-conditionality has given rise to several doubts. In the first place, a basic discrepancy is noted with regard to the growth-oriented adjustment strategy recommended by both institutions. This would basically advocate that the LDC involved achieve an equilibrium in the balance of payments that is compatible with the flows of payments for servicing its foreign debt and with the amount of new loans received; in that scheme, the rate of economic growth of the country is obtained as a residual. However, according to the Fishlow (1987), the view of the new growth-oriented adjustment strategy must be different. The goal is to ensure an adequate minimum level of growth, determining the volume of external resources needed by the LDC; what is obtained as a residual, then, is the flow of external loans. The crucial question then becomes: from where will these resources come?

In the second place, there is no theoretical model that describes the transition from a situation of imbalance to one of balance, particularly when that process includes defining the opportune moment and time sequence of structural reforms (trade opening, financial opening, market liberalization, lifting of economic regulations, etc.). The dynamics of the change in the presence of imbalanced markets is very difficult to describe, and there is simply no theoretical model of how to do it (Helleiner, 1986). Nevertheless, in a context in which imperfections and distortions predominate, it is foreseeable that cross-conditionality will systematically suggest the use of price incentives and the liberalization of everything that can be liberalized. This global approach can be defended only if it is applied judiciously and flexibly, but as a universal rule it is not valid or acceptable either politically or economically (Helleiner, 1986).

In the third place, it can be presumed that cross-conditionality impedes the negotiating process of each country with multilateral institutions, since it can conclude one negotiation only when it has concluded the others (Lizano and Charpentier, 1986). This would be similar to trying to solve a model of simultaneous equations with variable (and sometimes not clearly convergent) parameters, at the precise moment

when the country is urgently in need of external loans.

The following line of argument suggests the reasons for the establishment of *cross-conditionality*. The two types of *conditionality* of the IMF and the World Bank are supposedly a coherent, consistent and complementary policy framework; for growth-oriented adjustment to succeed, then, the programme must be applied as a whole. In order to guarantee that it is implemented effectively, it is advisable to have a mechanism like *cross-conditionality*. From the countries' viewpoint, its existence would deeply affect the socio-political stability of their governments, since compliance or non-compliance with various elements of the cross-conditionality would affect practically the *entire* flow of external loans obtained by the country. In the presence of a *cross-conditionality* between the IMF and the World Bank, the LDCs would then avoid having to resort to those international institutions to request credit; if they did so, they would be exposed to a delicate factor of political, economic and social instability.

Finally, the development strategy, the size and type of growth and other socioeconomic objectives are the main components of that at times vague concept, of national sovereignty. The degree of susceptibility of a country will be affected when there is an obvious intrusion into key economic and political areas, such as liberalization, deregulation, privatization and foreign investment. Suggesting and urging the adoption of an economic programme in terms of its impact on the balance of payments is a very narrow objective. Furthermore, the criterion for evaluating the success of that programme cannot be limited to how well it is able to cover the payment of debt servicing (Miller, 1986), but must take into account its impact on growth and on other socioeconomic objectives of a redistributive nature.

5. *The distribution problem*

From the country's point of view, achieving adjustment in a situation of external imbalance is a public good that supposedly benefits all its economic agents. Then why do they all not cooperate and make sacrifices to obtain it? How can the costs of the adjustment be distributed equitably? What is, from this angle, the most appropriate economic policy package? A similar set of questions is applicable in the case of the growth-oriented adjustment strategy; in this situation, it could be adduced that those who make sacrifices today will benefit tomorrow by greater growth. However, this reasoning raises many questions. What are the guarantees that those who make the greatest relative sacrifice in the present will really be compensated? Will that compensation be greater for those who have made the most sacrifices? How can the sacrifice of present well-being be compared to a potential future benefit? What compensation should be given to those who have been unemployed for a long time in order to facilitate the present adjustment, in view of the economic, psychological and social costs they have paid?

6. *Financing of the strategy*

Without a doubt, the basic problem of a growth-oriented adjustment strategy is that it demands a larger volume of resources over a longer period of time. This is because, in the case of Latin American economies, the strategy requires the introduction of deep-seated changes. The central goal —to expand aggregate supply, primarily of tradeable goods, in the medium and long term— assumes the mobilization of more resources than that of traditional IMF short-term adjustment programmes, which have been oriented toward reducing aggregate demand (Sengupta, 1987). On the other hand, external financial resources are essential in the early years of the application of the growth-oriented adjustment strategy, to avoid further reduction in per capita consumption. It is difficult to carry out a package of structural reforms in a context where the deterioration of an already depressed level of consumption is proposed. In a democratic régime, this lacks political viability.

In view of the prevailing international economic situation and the problems mentioned, the Latin American countries face very unfavourable prospects. A possible scenario is that international banking may not provide significant amounts of new medium-term loans. It is probable, in fact, that commercial banking may be largely concentrated on the financing (short-term credit) of foreign trade operations.

Moreover, it may be assumed that the resources from foreign investment and the possible aid from the governments of the industrialized countries will fall short of the needs of the strategy in question.

Two alternatives would then remain. The first would be to increase the amount of credit resources from IMF and the World Bank through, among other mechanisms, greater support from the member governments of those institutions, improved use of special drawing rights (SDR) by the Fund or an increase in the proportional amount of the Bank credits in relation to its assets (on this subject, see SELA 1986, and the 1987 report of the Group of 24). If this formula were applied, both international institutions would assume in the middle term a predominant role for the Latin American countries; hence the importance of an open and broad discussion on cross-conditionality. The second alternative would consist of a substantial reduction in the negative flow of financial resources from Latin America. In other words, it is practically impossible to reconcile the application of a growth-oriented adjustment strategy with the payment of foreign debt servicing in the presence of a declining (and rationed) supply of external credit. Thus, the flow of resources allocated by Latin American countries to debt servicing must be curtailed.

III

Some final proposals

This work has been oriented toward examining some general but crucial aspects of the problems linked to the conditionality of the IMF and the World Bank and its probable —and perhaps even imminent— application in the region. In an initial phase, it is possible to formulate only a few tentative suggestions about the direction that the analysis should take. In a later stage, the analysis must deal in greater depth with the basic principles and components of a conditionality that takes into account the interests of the Latin American countries.

The economists of the industrialized world have played a crucial role in defining the rules of the game and in the type of conditionality promoted by both institutions; supposedly, the views and vested interests of these countries will have an important impact on the final result. However, the IMF and the World Bank have not been rigid, unchanging institutions throughout the passage of time.[7] Moreover, as Keynes argues, the power of ideas in relation to that of vested interests should not be underestimated. Latin American economists must concentrate, then, on formulating proposals to reform the existing and potential conditionalities of multilateral institutions which are more acceptable and beneficial to the interests of the region. The recent articles of Edmar Bacha (1983, 1985, 1986, 1987) provide a guideline for the type of research that must be promoted in the region.

The following is a brief list of proposals:

1. The transfer of resources from Latin America to the exterior in an amount equivalent to 4% of the gross domestic product (GDP) is completely incompatible with the growth-oriented adjustment strategy. The countries of the region cannot continue to maintain a negative flow of resources of that magnitude. This means that a definitive solution to the problem of the Latin American foreign debt, which at this point is essentially a political rather than economic issue, cannot be deferred. However, as Dornbusch has observed, today, unlike what happened in the 1920s and 1930s, the problem has been insistently considered to be a basically economic one.[8] It is high time to apply some of the many solutions that have been suggested.[9]

[7]Guitián (1981) and de Vries (1986) examine the growth and changes experienced by the IMF. Annis (1986) and Feinberg, *et al.* (1986) do the same for the World Bank.

[8]Quoted in Miller (1986), p. 84.

[9]On this subject, see Ffrench-Davis and Feinberg (1986); Massad (1986); de Carmoy (1987).

2. The conditionalities promoted by international institutions have to be reviewed and readjusted so as not to impose on the countries excessive adjustment costs or technico-ideological solutions incompatible with the majority preferences of their citizens.

For an IMF or World Bank programme to be acceptable and viable, the goal of correcting the imbalance in the balance of payments must be subject to the obtention of at least a minimal growth rate compatible with the country's supply of resources and progress toward redistributive social goals. Adjustment processes and structural reforms involve high costs for the poor; unfortunately, the same occurs with "non-adjustment." The basic problem lies in how to redistribute equitably the sacrifices involved in the adjustment.

New loans from the IMF and World Bank must not be used to repay the foreign debt, since in that case they would not be used for financing the growth-oriented adjustment strategy. Moreover, it is advisable for both institutions to defer the payment of amortizations and the servicing of loans during a certain period while the countries introduce the changes required by the adjustments and structural reforms.

On the one hand, if in a given country the Fund and the World Bank are going to operate simultaneously, it is reasonable to expect that the conditionalities promoted by these institutions be uniform and consistent. On the other hand, the host country has to be able to express an opinion and have an influence on the type of cross-conditionality that will be applied to it. In any case, it must be explicitly stipulated in each of the agreements that a cross conditionality neither exists nor is in force.

3. The main guidelines for IMF conditionality would be the following:[10]

a) Reverse conditionality. The adjustment programme must be designed by the borrowing country, taking into account the existing external restriction. Thus, the homogeneous and uniform programmes of the IMF would be replaced by "home-made", "fitted" adjustment programmes. This proposal is probably more significant for the small countries than for the larger ones, since the latter have a greater bargaining power.

Now let us look at this conditionality from an operational standpoint. A country presents the IMF with its adjustment programme and a request for credit. IMF experts review the consistency and viability of the programme. If serious disagreements arise over its feasibility, the Executive Director is called in to settle them. The final result probably consists of a compromise solution between the adjustment programme submitted by the country and the observations suggested by the IMF experts. But what is crucial about this process is the point of departure of the negotiations, since the final result commonly depends on the initial terms of the discussion.

b) Conditionality that takes into account variables of the real sector of the economy. In order to put a ceiling on the domestic cost of adjustment, it could be stipulated that when given levels are exceeded in the decline in the product or the increase in the unemployment rate, the country will be provided with further increases in external credit. The programme signed by Mexico in 1985 contained a clause of this type.

Thus, Bacha (1987) suggests that the financial-budgetary exercises traditionally carried out by the Fund be complemented by national feasible economic growth rate exercises, from which will evolve, as a residual, the volume of financial resources necessary for supporting a given rate of expansion of the product.

The identification of that minimum rate (consistent with adjustment), which can be used as a point of reference for all countries, can cause some difficulties. The zero figure always holds great attraction, inasmuch as it could be asserted that zero growth in per capita income means that the current levels at least do not deteriorate. But this would mean applying a stricter criterion to those countries that have a higher rate, which would make no sense.[11]

[10]See Group of 24 (1987); Bacha (1985) and (1987); SELA (1986).

[11]The application of the "rule of two", i.e., dividing by two the average value of the country's economic growth rate for the last five years, is probably a less discriminatory criterion. This "rule of two" would have a precedent in the financial exercises of the Fund, which would use it in order to determine the level of fiscal deficit that must be reached by the (Latin American) countries in order to implement the adjustment programme (Bacha, 1987).

c) Conditionality at two levels. In this case, it is suggested that a distinction be made between the external variables (those linked to the balance of payments and international reserves), measured in foreign currency, and internal variables (fiscal deficit, domestic credit, inflation), measured in local currency. The priority conditionality for the IMF would be that corresponding to the variables expressed in foreign currency; the domestic goals would then be relaxed when the external goals have been met (Bacha, 1985).

Spraos (1986) suggests a more extreme option. IMF conditionality must be centred on a single goal, the balance of payments, and later using only indicators (targets, in this case) linked directly to external accounts. Bacha (1987) feels, from a pragmatic standpoint, that it is more feasible to achieve a modification in IMF conditionality toward a conditionality at two levels, as previously indicated, which attempts to eliminate a considerable part of the existing conditionality. From the perspective of the countries, conditionality at two levels would substantially fulfil a very similar function to that of the one centred exclusively on the balance-of-payments objective.[12]

d) Consistency between the level of external variables and the minimum goal of economic growth stipulated. This level has to take into account: i) an adequate expansion of domestic credit (probably with one quota that is lower and another that is higher), so as to maintain enough liquidity to sustain the desired level of growth; ii) a fiscal deficit that ensures the essential levels of public investment and social spending for achieving the objectives of economic growth and alleviation of poverty and redistribution of prosperity.

e) Expansion of the compensatory financing facility (CFF) in order to cover a major proportion of the drop in exports and consider possible variations in the international interest rate. The impact of the fluctuations of this variable has acquired great importance for Latin American debtor countries. It would probably be more logical for access to the CFF programme to be related not to the quota that each country contributes to the Fund, but to the amount generated by the external maladjustment (associated with the fall in exports or the increase in the interest rate).[13]

4. The Bank should consider the following criteria in the design of its conditionality.[14]

a) Return to its foremost objective of the 1960s and 1970s, that is, eradication of poverty and redistributive growth. In terms of adjustment programmes, conditionality must specifically consider: i) alternative strategies that minimize social costs; ii) compensation mechanisms that cushion the impact on the poorest groups; iii) mechanisms that distribute equitably the sacrifices of adjustment, and iv) specification of the distributive impact of different alternatives.

The above has not been resolved either theoretically or empirically. Thus, it must become a priority objective within the World Bank research programme. The UNICEF approach of "adjustment with a human face" (Cornia, Jolly and Stewart, 1987) points out the urgency of protecting the maintenance of minimum nutritional levels for children and of meeting the basic needs of other vulnerable groups. In this sense, it is suggested that during the process of adjustment, the progress not only of the balance of payments and inflation, but also of the nutritional state and meeting of the basic needs of the

[12]Spraos (1986) raises an additional problem with respect to the indicators (targets) included in the conditionality, which are the frames of reference for determining the performance (or non-performance) of the agreed adjustment programme. Should they be linked to the policy *goals* or *instruments*? The IMF uses as a criterion the level of the instruments. Thus it is supposedly possible to discern when the non-performance of an adjustment programme is caused by endogenous or exogenous factors; a country would be responsible only when it does not meet the goals of a programme that is under its control (Kenen, 1987). But how can those cases in which the governments do not retain total control over the instruments be distinguished? Spraos also points out some of the difficulties involved in the use of instruments as *targets*: i) there must be a stable and very well-defined relationship between the policy instrument and the objective for which it is being used; ii) there is not always an operationalization of the instrument which indicates that it is the best; this is illustrated by the various types of M_1 used to tie in to the concept of money; iii) the instrument selected has to be the only one that can alter the value of the objective variable in the direction desired. Obviously, it is difficult for all of these requirements to be met in the real world.

[13]Other proposals by the Group of 24 (1987) are that: i) the IMF should not set precise quantitative goals, but ranges of goals for crucial variables; and ii) CFF programmes must definitively replace standby loans.

[14]See Helleiner (1986); Feinberg, *et al.* (1986); Feinberg and Bacha (1987).

most vulnerable and lowest income groups should be subject to constant scrutiny. The experience of Great Britain during the Second World War shows that it is feasible to make both nutritional concerns and progress in the adjustment programme compatible, even during extremely pressing times.

b) Maintenance, whenever possible, of the recently prevailing relative weight of loans for specific investment projects. Within these, it seems advisable to favour those which generate the most jobs; for example, loans to medium and small businesses, or loans for the labour-intensive construction of low-cost housing (with a maximum of square metres).

c) In relation to structural adjustment loans, the Bank should concentrate on those of a sectoral nature. From the political standpoint, structural adjustment loans (SAL) involve smaller amounts of resources than those associated with the reforms included in their conditionality. On the other hand, some loans oriented toward sectoral adjustments do not require the application (or consistency) of a macroeconomic programme with the IMF; this is the case of those that are set up to improve nutritional status or human capital or to strengthen the energy policy or the infrastructure of a country.

d) Support for an export promotion strategy, about which there is a high level of consensus. In the modern interdependent world, the external sector plays a crucial role for small and medium-sized countries (categories that include all Latin American nations). In order to stimulate overseas, sales, the following are suggested, among other measures: i) maintaining a stable exchange control, under which local currency is permanently (for a reasonably long period of time, i.e., 10 to 15 years) slightly undervalued; ii) eliminating all the obstacles to the importation of inputs used in exports. It would also be appropriate to use a direct export subsidy mechanism (for marginal and/or new exports) for an initial period of no less than five years, which would decrease and eventually be eliminated. This mechanism is justified by arguments similar to those supporting the protection of infant industries. This type of measure, which is especially oriented toward the export sector, is undoubtedly preferable to the unrestricted, indiscriminate liberalization of imports.

It is obvious that the private sector responds positively to the appropriate economic incentives; consequently, by applying the criteria described, it can be transformed into a vital agent for the expansion of Latin American exports. On the other hand, although the private sector and the market mechanism play a key role, government action is still indispensable in a number of aspects. It is responsible, in fact, for establishing a propitious global context; providing the basic infrastructure and motivating the human capital formation adequate for development; encouraging and, in some cases, initiating certain types of activity that, owing to their externalities and economies of scale, do not attract the private sector in the beginning. Although they may be transferred *a posteriori*; promoting active trade policies, through bilateral or multilateral agreements and through embassies that provide the pertinent information, etc.

In order for there to be success in the current competitive international world, nobody can be excluded; on the contrary, all the economic agents of a country must push the cart of the economy in the same direction. The, somewhat obvious moral is that the Latin American countries necessarily have to establish and operate a mixed economy, in which both the private sector and the State play important roles. The polar systems with values of 0 or 1 for the economic roles of the private and public sectors —no matter which one is assigned the 0 or the 1— are doomed to failure. Nevertheless, each country has to define the optimal combination for itself.

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